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Financial Markets

Irving Trust

Irving Trust Company
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New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Dec. 19, 1980

Financial markets, nervous and on the lookout for some palpable indication that the peak in interest rates is here, finally seized on a potential harbinger of reduced rate pressures: a report on Wednesday that the incoming Reagan Administration was considering a set of emergency economic measures to present to Congress shortly after the inauguration. Although little in the proposals was new, the prospect led to a substantial rally this week, as many dealers--especially those with short positions--got "peak fever." The disease was easy to contract, since dealer positions in general were extremely light. In contrast, retail demand was much more immune.

That underscored the fragility of the rally. Besides the fact that the Reagan proposals were tentative, with uncertain legislative prospects, some participants were reminded of the "moral equivalent of war"--big words followed by few tangible results. Indeed, early escalation of rhetoric clearly carries a risk of increasing cynicism and disappointment later on, when the legislative mill grinds slowly. In addition, financing rates, reflecting Federal funds stuck in the 20% area, are well above rates on Treasury securities. Thus, as has happened several times in the last several weeks, the rally may stall or retreat temporarily due to lack of confirmation in the funds rate. All in all, then, the market is far from convinced that the peak really is here.

The FOMC met today against a background of economic data suggesting continued economic recovery in the current quarter--albeit with signs of weakness starting to emerge, especially in the rate-sensitive housing and auto sectors. The recent weakness of commodities prices should provide some satisfaction to the Committee members. Nonetheless, M-1B remains well above the top of its target, and there seems little prospect of an easing of the Fed's policy stance being voted at the meeting. Rather, the best bet is that policy will be left essentially unchanged, so that any near-term declines in the funds rate must be validated by a slowing in the pace of monetary growth.

Market participants should be impressed by the Fed's determination to take seriously its goal of gradually slowing the long-run rate of monetary growth. In past months, rumors have abounded that the Fed was either targeting interest rates, playing politics with the short-term growth of the money stock, or--whatever. There is no question that credibility has been a scarce commodity lately, given the economy's miserable inflation performance. But credibility can be earned, and Chairman Volcker and the other Committee members seem to understand that.

Near term, as we have emphasized several times in earlier letters, we have doubts concerning the trend of interest rates. By early next year, however, we are confident that rates will be declining substantially.

William C. Melton

Note: The full text of this letter is available to Telerate Subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	12/19/80 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	21.00%	20.00%	15.25%
Effective since	12/16/80		
Discount Rate at Federal Reserve Bank	13.00%	13.00%	12.00%
Federal Funds	20.50	20.00	13.88
Repurchase Agreements	19.25	19.75	12.63
U.S. Treasury Issues			
Bills			
3 months	15.62	17.57	12.65
6 months	15.19	16.84	12.66
1 year	14.38	15.49	11.88
Coupons			
2 years	14.06	14.77	11.38
4 years	13.32	14.04	10.54
7 years	12.80	13.40	10.36
10 years	12.60	13.26	10.42
Long Bond	12.19	12.92	10.16
Negotiable Certificates of Deposit-Secondary Market			
1 month	20.15	20.90	13.30
3 months	19.15	20.50	13.40
6 months	17.10	18.55	13.50
1 year	16.00	15.50	12.50
Banker's Acceptances			
1 month	19.90	20.50	13.50
3 months	18.75	20.85	13.60
6 months	16.00	18.65	13.55
Eurodollar Deposits			
1 month	21.25	22.38	14.69
2 months	20.75	21.63	14.69
3 months	19.88	21.25	14.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	19.50	19.38	11.00
1 month	17.00	17.50	13.50
3 months	16.50	16.00	12.00
Bank Holding Companies			
1 month	19.75	20.25	13.38
Dealer Placed:			
3 months	14.00	20.00	13.50
New AA Corporate Utility Bond	14.50	15.25	11.85
Tax Exempt			
6 month Project Notes	8.40	8.75	5.75
1 year AAA Bond	7.90	8.00	NA
5 year AAA Bond	8.30	8.00	NA
20 year AAA Bond	10.00	9.75	6.75

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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